Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
1998 Biennial Regulatory Review --	)	CC Docket No. 98-195
Repeal of Part 62 of the	)	
Commission's Rules	)	

COMMENTS OF THE SECURITIES INDUSTRY ASSOCIATION

The Securities Industry Association ("SIA") respectfully submits these comments on the Commission's Notice of Proposed Rulemaking ("NPRM") in the above-captioned docket. The NPRM proposes to forbear, under section 10 of the Act, from enforcing only the first part of section 212 of the Communications Act of 1934, as amended ("Act"). *See* NPRM ¶ 2 n.13. That proposal does not go far enough, and SIA requests that the Commission forbear from enforcing the last sentence of section 212 as well. Many of the same reasons that justify forbearance from the first part of the section, which governs interlocking directorates, also warrant forbearance from the last sentence, which makes it unlawful for an officer or director of a carrier to benefit from certain transactions involving that carrier's securities.[1/] Enforcement of this latter provision, like the former, is not necessary to protect consumers or competition. Further, forbearance is in the public interest.

SIA is the leading proponent of capital markets, bringing together the shared interests of about 800 securities firms throughout North America to accomplish common goals.

1/ The last sentence of section 212 provides: "[I]t shall be unlawful for any officer or director of any carrier subject to this chapter to receive for his own benefit directly or indirectly, any money or thing of value in respect of negotiation, hypothecation, or sale of any securities issued or to be issued by such carrier, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of such carriers from such funds properly included in capital account." 47 U.S.C. § 212.

SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and in all phases of corporate and public finance. In the United States, SIA members collectively account for approximately 90 percent, or $100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans.[2/]

SIA's interest in this proceeding stems from the limitation that the last sentence of section 212 places on the ability of its member securities firms to perform underwriting or related services for telecommunications carriers. That limitation may make it costlier and more difficult for securities firms to perform even routine financial services for telecommunications clients: An officer or director of a carrier theoretically could "benefit . . . in respect of" a securities firm's underwriting of the carrier's securities -- potentially in violation of section 212 -- if that officer or director also were an officer or director of a securities firm.[3/] The individual's compensation from the securities firm might be indirectly affected by the underwriting -- for example, if the individual's compensation were based on the overall financial performance of the securities firm (or a unit thereof) -- thereby improperly causing that "officer or director of [a] carrier . . . to receive for his own benefit" something of value. Such a scenario is not merely hypothetical; some SIA members have officers or directors that also serve (or may wish to serve) on the board of a carrier.

2/ Additional information about SIA is available on its Internet website at www.sia.com.

3/ An individual of course would not serve as an officer of both a carrier and a securities firm. But it would not be uncommon for an individual to serve as an officer of a carrier and director of a securities firm, or vice versa, or as a director of both.

This potential for liability under section 212 -- which could include both civil and criminal penalties[4] -- may deter a carrier from using the services of a securities firm that has an officer or director sitting on the carrier's board (or vice versa), thereby restricting the carrier's choice among firms and concomitantly the diversity of financial advice it may receive. Or, the boards of both the carrier and the securities firm would have to adopt burdensome procedures to ensure that any person serving both corporations does not benefit personally from underwriting of the carrier's securities by the securities firm. In addition, the prospect of section 212 liability might artificially limit a carrier's (or securities firm's) ability to select the most qualified executives as officers or board members. All of these costs and burdens are imposed unnecessarily, however, as SIA shows below.

THE COMMISSION SHOULD FORBEAR FROM ENFORCING THE LAST SENTENCE OF SECTION 212.

As the NPRM notes, "in the Telecommunications Act of 1996 ("1996 Act"), Congress sought to establish a 'pro-competitive, deregulatory national policy framework' for the United States telecommunications industry." NPRM ¶ 2 (citation omitted). Section 10 of the Act accordingly provides that the Commission *shall* forbear from applying any provision of the Act to a telecommunications carrier or service (or class of carriers or services) if it determines that

> (1) enforcement of such . . . provision is not necessary to ensure that the charges, practices, classifications, or regulations by, for, or in connection with that telecommunications carrier or telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory;

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[4] *See* 47 U.S.C. § 501.

> (2) enforcement of such . . . provision is not necessary for the protection of consumers; and
>
> (3) forbearance from applying such provision . . . is consistent with the public interest.

47 U.S.C. § 160(a). In determining whether forbearance from enforcing a particular provision is in the public interest, the Commission is required to consider whether forbearance will promote competitive market conditions. *See id.* § 160(b). Forbearance from enforcement of the last sentence of section 212 is plainly warranted under the statute's three-part standard, because the provision is not necessary to protect consumers or competition and because forbearance is in the public interest.

A. Enforcement Is Not Necessary To Assure Just and Reasonable Rates and Practices.

Forbearance would have no impact whatever on whether carriers' rates and practices are just and reasonable. Congress enacted the last sentence of section 212 to guard against self-dealing by officers and directors of a carrier;[5/] it sought to prevent, for example, the risk of carrier rate increases to cover the higher costs that might flow from a self-dealing transaction. But, as the NPRM observes, "the specific concerns section 212 sought to address can be addressed, if necessary, through other Title II provisions" or other statutes and regulations. NPRM ¶ 15.

Most significantly, section 201(b) of the Act independently provides that "[a]ll charges, practices, classifications, and regulations for and in connection with . . .

5/ *See* S. Rep. No. 73-781, at 4 (1934); *see also* H.R. Rep. No. 73-1273, at xx-xxi (1934). The legislative history demonstrates congressional concern that officers of what was then the nation's largest holding company for independent telephone companies had borrowed the company's treasury stock and pledged it as collateral for personal loans. *See id.*

communications service[s], shall be just and reasonable, and any such charge, practice, classification, or regulations that is unjust or unreasonable is hereby declared to be unlawful." 47 U.S.C. § 201(b). This provision by itself renders the last sentence of section 212 superfluous as a means of ensuring the reasonableness of carrier rates and practices. *See also id.* § 202(a) (prohibiting discrimination by carriers).

Perhaps because of the efficacy of section 201(b), the Commission has had no occasion to apply the last sentence of section 212. The NPRM queries whether the relative lack of filings relating to the *first* part of section 212 and the Commission's implementing regulations suggests "that the requirements of section 212 of the Act . . . are not necessary to ensure just and reasonable rates." NPRM ¶ 15. With respect to the *last* sentence of section 212, the answer is a resounding "yes." There apparently have been *no* filings with the Commission or a court suggesting a possible violation of the last sentence of section 212 in the provision's 64-year history. In fact, the Commission has not even promulgated rules or regulations implementing the provision, and there appear to be no reported administrative (or judicial) decisions interpreting it.[6/] The apparent absence of any complaints or independent enforcement by the Commission demonstrates that, if any self-dealing by carrier executives has occurred, aggrieved parties (and

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[6/] SIA's research uncovered one informal advice letter concerning the Commission's interpretation of the last sentence of section 212. S.G. Warburg & Co. requested clarification of the legality of a transaction under section 212 where Warburg proposed to serve as an underwriter for a secondary offering of AT&T securities owned by British Telecom, and Warburg's Chairman also served as a director of AT&T. The Common Carrier Bureau staff advised that (1) the statute was not designed to cover secondary offerings and (2), in any event, because the sale of the securities would benefit British Telecom, not AT&T, the AT&T/Warburg interlock would not cause a violation of the statute, especially in light of steps Warburg took to ensure that its Chairman would not benefit personally from the underwriting transaction. *See* Letter of Roger J. Hertz to John S. Logan, dated Sept. 29, 1994.

regulators) have turned to other laws for remediation. Therefore, forbearance from the last sentence of section 212 would not have any detrimental effect.

In addition, the generally competitive nature of the telecommunications industry serves as a further bulwark against conduct that could result in unjust or unreasonable charges or practices. Carriers providing interexchange, wireless, and satellite services all compete vigorously within their respective areas, and, increasingly, across traditional service boundaries. Competition in local exchange services appears to be emerging rapidly.[7] Indeed, the pending merger of AT&T and TCI is expected to introduce a formidable new competitor into the local telephony business. In competitive markets, there is very little chance that a carrier could benefit by engaging in conduct proscribed by the last sentence of section 212 -- say, by paying deliberately inflated charges to underwriters and then attempting to recoup them through above-market rates. The market inevitably would punish a carrier that attempted such a scheme.[8] Where competition is not yet robust, the Commission's regulations similarly prevent carriers from capitalizing on anticompetitive conduct. Large incumbent local exchange carriers, for example, are subject to price cap regulation, which virtually eliminates the incentive to impose unreasonable charges.[9]

7/ *See, e.g.*, Press Statement of Chairman William E. Kennard on the Second Anniversary of the Telecom Act of 1996, Jan. 30, 1998 (available on the Internet at www.fcc.gov/Speeches/Kennard/Statements/stwek804.html).

8/ *See* NPRM ¶ 15 ("the Act's objectives of just, reasonable, and not unjustly or unreasonably discriminatory rates can be achieved through market forces and the administration of the complaint process").

9/ *See Computer III remand proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Carrier Safeguards*, 6 FCC Rcd 7571 ¶ 6 (1991) (LEC price cap regulation reduces incentive to engage in anticompetitive conduct because "a carrier is not able

(continued...)

Finally, certain elements of modern corporate and securities laws complement the prophylactic effects of section 201(b) of the Act and competitive markets. For example, state laws impose a strict fiduciary duty of loyalty on the officers and directors of corporations, including carriers. *See* Robert C. Clark, *Corporate Law* §§ 4.1, 5.2 (1986). Such laws strongly deter carrier executives from engaging in conduct that would deliberately waste corporate assets and in turn cause the carrier's charges, practices, classifications, or regulations to become unjust or unreasonable -- especially in light of the advent of class action litigation. Moreover, federal securities regulations impose various disclosure requirements that similarly make the likelihood of improper conduct remote. Public corporations, including most carriers whose conduct could implicate section 212, must disclose the existence of transactions in which an officer or director (among various other interested parties) had or will have a direct or indirect material interest, subject to minimum transaction size thresholds. 17 C.F.R. § 229.404. Underwriters also must disclose "material relationship[s]" with issuers[10/] -- a category that might include the example described by SIA above, where an officer or director of a securities firm also is an officer or director of a carrier. *See supra* at 2. These requirements, like the principal securities acts generally, are founded on the precept that "sunlight is the best disinfectant."[11/] As Justice (then Professor) Frankfurter, a major architect of the Securities Act of 1933, stated in anticipating the statute's impact:

9/ (...continued)
automatically to recoup misallocated nonregulated costs by raising basic services rates").

10/ *See* 17 C.F.R. § 229.508 (1998).

11/ *See, e.g.*, 57 SEC Docket 2315 (Oct. 27, 1994) (quoting L. Brandeis, *Other People's Money and How the Bankers Use It*, 92 (Frederick A. Stokes Co. ed. 1932)).

> The existence of bonuses, of excessive commissions and salaries, of preferential lists and the like, may all be open secrets among the knowing, but the knowing are few. There is a shrinking quality to such transactions; to force knowledge of them into the open is largely to restrain their happening. Many practices safely pursued in private lose their justification in public.[12/]

Rules implemented by the major broker-dealer self-regulatory organization likewise apply to the sorts of transactions and relationships with which Congress was concerned in enacting the last sentence of section 212 in 1934.[13/]

B. Enforcement Is Not Needed To Protect Consumers.

Enforcement of the last sentence of section 212 also is not necessary for the protection of consumers. Just as "interlocking directorates rarely, if ever, raise consumer concerns," NPRM ¶ 16, conduct that might be deemed to violate the last sentence of section 212 -- such as the example of an overlap between a carrier and securities firm, *see supra* at 2 -- also fails to raise consumer concerns, for all of the reasons discussed above. Indeed, as noted, the last sentence of section 212 appears not to have raised *any* concerns in its 64-year history. "In the unlikely event" that a consumer-related concern arises in the future, "the Commission's enforcement powers [under section 201 and other provisions of the Act] will protect consumers against any adverse effect that might occur." NPRM ¶ 16.

12/ F. Frankfurter, *The Securities Act: Social Consequences*, Fortune, Aug. 1933, at 55.

13/ *See, e.g.*, National Association of Securities Dealers, Inc. ("NASD") Manual, Rules 2710(b) (requiring the filing of certain disclosure documents with the NASD with respect to certain offerings) and 2710(c) (proscribing unfair or unreasonable underwriting or other arrangements in connection with public offerings) (CCH April 1998); *see also* Rule 2720 (addressing conflicts of interest between NASD members and affiliated entities).

C. Forbearance Would Serve the Public Interest.

Finally, forbearance from enforcement of the last sentence of section 212 is consistent with the public interest. The NPRM appropriately concludes that forbearance "will promote competition in the various markets affected by the requirements set forth in section 212 of the Act." NPRM ¶ 17. Carriers and securities firms that now engage in transactions in spite of an officer/director or director/director overlap -- after adopting measures to avoid the rigid strictures that section 212 arguably imposes -- would be freed from the costs of designing and implementing such measures. As the NPRM notes, "the Commission previously has found that elimination of unnecessary regulatory burdens and legal costs permit resources to be directed instead toward" more productive and procompetitive uses. *Id.* Carriers also would have access to a broader range of securities firms for underwriting and related services and would have a freer hand in selecting officers and directors absent the constraints in the last sentence of section 212. *See supra* at 2-3. Such benefits would warrant forbearance even if competition in relevant markets were not enhanced.[14/]

[14/] *See Bell Operating Companies*, 13 FCC Rcd 2627, ¶ 46 (1998) (demonstrating enhancement to competition is not necessary to satisfy public interest prong of forbearance analysis).

CONCLUSION

For the foregoing reasons, the Commission should forbear from enforcing the last sentence of section 212 of the Act.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on December 14, 1998, copies of the Comments of the Securities Industry Association have been served by hand on the parties listed below.

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